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SUMMARY

I. We believe that Conclusion B (first sentence) is incomplete and misleading and therefore of little value for policy guidance.

II. One of our major criticisms of NIE 100-55 is that conclusions C and G unduly minimize the significance of the paper's principal finding, that reduction of ChinCom controls to CoCom levels would add about $200 million to Communist China's annual foreign exchange earnings. (We consider this figure very conservative. There is evidence to support an estimate of almost double this amount.)

III. Another fundamental objection to the NIE is its failure to deal adequately with the strategic impact of shipping and bunkering controls.

IV. One serious defect of NIE 100-55 is that the Conclusions, particularly paragraphs B and C, do not incorporate or reflect significant portions of the factual data upon which they supposedly are based.

V. A major weakness of NIE 100-55 is the probable underestimation (Conclusion G and para 31, mainly) of the effect of reduction of ChinCom controls to CoCom levels on the amount of foreign exchange resources.

VI. NIE 100-55 presents conflicting evidence on the rapidity of the effects on Communist China's imports of reducing controls and fails to point up the security implications.

VII. NIE 100-55 does not reflect clearly the pattern of the economy of Communist China, its present stage of development and current rate of growth.

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S-E-C-R-E-T

I. We believe that Conclusion B (first sentence) is incomplete and misleading and therefore of little value for policy guidance.

The reasons we feel this way are the following:

1. The requirements for the "rapid expansion of military strength and industrial output", here referred to, have been provided from the following sources --

(1) Lend-Lease, UNNRA and ECA aid to China up to November 1949 totalling about $2.4 billion ("a large proportion of the goods so furnished were lost to Communists");

(2) Japanese properties and assets;

(3) Direct imports from non-Communist areas;

(4) Shipping services of non-Bloc countries;

(5) Soviet Union military and economic aid;

(6) Transshipped Western commodities since the imposition of controls.

It remains to be proved, as here implied, that the recovery and growth of industrial output in Communist China since 1950 is attributable even mainly to what has been contributed from Soviet Bloc sources, or that this rate of expansion can be sustained by what it will be able to draw from Soviet Bloc sources.

2. A conclusion which assumes or implies that there can or will be no tightening of controls toward the European Soviet Bloc, or fails to recognize such a possibility, is incomplete and liable to be misunderstood especially when such a tightening, together with recently adopted transshipment controls, probably could reduce drastically the transshipment potential.



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II. One of our major criticisms of NIE 100-55 is that conclusions C and G unduly minimize the significance of the paper's principal finding, that reduction of CHINCOM controls to COCOM levels would add about $200 million to Communist China's annual foreign exchange earnings. (We consider this figure very conservative. There is evidence to support an estimate of almost double this amount.)

The reason we feel this way is that it would have an entirely different significance as policy guidance if, instead of introducing this finding (as in C) with the unsupported statement that "trade controls have not significantly hindered China in obtaining essential commodities," it could be pointed out that --

1. $200 million of additional annual resources is roughly equivalent to 2/3 of the annual average of Lend-lease-UNNRA-ICA aid to China from July 1941 to November 1949, amounting in total to $2.4 billion.

2. This $200 millions annually is more than 3 times the annual average amount of Soviet credits to China, described in paragraph 4, page 7, for the period 1950-54 and 1955-59.

3. For $238 million (alone), allocated for economic development by UNNRA during 1945-47, the following principal items were provided to China:

300 transport vessels (100,000 tons)
268 locomotives
3400 freight cars
86,000 tons of rails
500,000 railroad ties
43,000 tons of bridge materials



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and an unspecified number of barges, dredges, cranes, machine shops, repair shops, shop equipment and tools, mining equipment, machine tools, and waterworks equipment sufficient to rehabilitate 32 main waterworks.

4. The strategic significance of $200 million additional annual resources is indicated by conclusion H which states that "China's foreign exchange earnings would almost certainly continue to be used primarily to procure imports of capital goods -- essential to building the modern industrial sector of the economy, and to modernizing the armed forces."

The introductory clause of para c which states that "trade controls have not significantly hindered China in obtaining essential commodities" is evidently inferred from Conclusion B. It is believed to be an unsupported assertion. Furthermore, it is contradicted by the estimate in the succeeding sentence that the effects of trade controls represent a loss to China of roughly $200 million a year amounting to 20% of imports, 5% of annual investment and equal to 50% of total capital goods imports, "the scarcity of which constitutes a particularly serious problem in the Chinese economy". Clearly any influence that has denied Communist China $200 million annually, which could have been used to purchase seriously needed additional capital goods imports, has more than "significantly hindered China in obtaining essential commodities."



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III. Another fundamental objection to the NIE is its failure to deal adequately with the strategic impact of shipping and bunkering controls.

Much of the NIE is predicated upon the assumptions that half of China's foreign trade moves overland (by routes not directly vulnerable to trade controls) and that overland transport could and would absorb any essential foreign trade denied by sea. Such assumptions are not supported by any estimate of the rate of freight transloading between the Trans-Siberian and the Chinese transportation system. As a result, an assumed integration of Russian-Chinese overland transport for large amounts of freight is used to calculate the quantity and infer the composition of at least half of China's foreign trade.

In consequence of this assumed integration, there is an underestimate of China's continuing dependence on shipping for both coastal and foreign trade.

To the extent that the assumptions of transport performance by the Trans-Siberian and of transloading are unproved or weak, the underestimate of shipping becomes more serious. Should those assumptions prove to be in error to any appreciable extent, any conclusions based on them regarding the effectiveness of controls could seriously misguide policymakers.



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IV. One serious defect of NIE 100-55 is that the Conclusions, particularly paragraphs B and C, do not incorporate or reflect significant portions of the factual data upon which they supposedly are based.

Paragraphs B and C cite paragraphs 10, 11, 12, 13, 14 and 17 as specific references. Nevertheless, the conclusions as stated do not reflect the following significant facts in those paragraphs.

1. Trade controls "have limited the availability to China of certain commodities which would assist military and industrial development." (para 10)

2. "The difficulties of obtaining replacement parts for Western equipment and some specialized commodities in short supply in the Soviet Bloc probably have created problems, particularly in the fields of transport, communications, and electric power." (para 11)

3. "To the extent that trade controls have slowed China's industrial expansion they have retarded the growth of its military potential." (para 13)

4. The stresses and strains within the Bloc caused by non-Communist trade controls are probably reflected in the present interest of both Peiping and Moscow in increasing China's trade with non-Communist countries. (para 17)

5. Industrial output, despite recent gains, is only "somewhat higher than previous peaks." (para 11)

In contrast, statements of generally opposite tenor from the cited paragraphs are identifiable in the Conclusions.



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V. A major weakness of NIE 100-55 is the probable underestimation (Conclusion G and para 31, mainly) of the effect of reduction of CHINCOM controls to COCOM levels on the amount of foreign exchange resources.

The reasons are failure to take account of (a) the estimate of Chinese exports to Japan given in para 30, (b) assumption of an expanding market in the US, consequent on a steady rise in National income and a reasonably liberal tariff policy, (c) the effects of releasing the $100 million of Chinese assets blocked in the US including the psychological effects on the millions of Chinese in other countries outside Communist China, in respect of "remittances", and (d) the price consequences of competition among Western industrial nations in the supply of the Chinese market.



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VI. NIE 100-55 presents conflicting evidence on the rapidity of the effects on Communist China's imports of reducing controls and fails to point up the security implications.

1. The following statements appear to indicate the necessity for a decided time lag in effectuating marked adjustments in international trade.

(1) Paragraph G, p. vii states that "within two years after controls were lowered China might add about $200 million to its annual earnings of foreign exchange."

(2) Paragraph 28, p. 27 that "China would probably have difficulty regaining its markets in the US and in any case this process would require time. We estimate that within two years China could increase its net export earnings by $60 to $80 million if it had free access to the US market."

(3) Paragraph 30, p. 28 "... we believe that the value of Chinese exports to Japan might be raised by 1957 from the present figure of about $40 million a year to about $100 million."

2. In contrast, the following quotations indicate the speed with which adjustments in trade can be made. This is particularly true in the case of capital goods, since normal heavy inventory carried by most companies obviates the necessity of waiting for new manufactures.

(1) Paragraph 6, p. 9a. "The 1953 four-fold increase over 1952 in direct Western European exports to Communist China resulted largely from the fact that Western Germany, the UK, France, and Switzerland increased their exports to China of iron and steel,



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machinery and instruments, chemicals, and wool. However, as a result of the imposition of controls on the export of iron and steel to China (effective August 1953), Western European exports declined in the second half of 1953 and remained at a lower level in 1954."

(2) Paragraph 6, p. 10. "Imports (China's) from Japan have increased rapidly following the reduction of Japanese export controls to the CHINCOM level." (from $5 million in 1953 to $15 million in 1954.)

3. The short run effect of trade controls and their objectives are obscured by statements such as:

(1) Paragraph A of Conclusions, p. iii. "Except to the extent that the USSR extends grants or credits, China's capabilities to import will be limited by its capabilities to export."

(2) Paragraph 18, p. 20. "In the long run, however, China's total capability to import will continue to be limited by its ability to export."

4. The conflict between the two series of statements in 1 and 2 might be resolved by taking account of:

(1) The immediate effects of the release of $100 millions of Chinese assets blocked in the U.S.

(2) The immediate effects of the restoration of a normal basis for commercial (short term) credit.

(3) The extent to which, under state trading, it is possible to accumulate debts on trading account, both private and intergovernmental.

5. The security implications of a relatively large increase in foreign exchange resources in a planned economy under Communist dictatorship are indicated in the following quotations from NIE 100-55.



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(1) Paragraph 9a, p. 14. "Both Moscow and Peiping apparently desire some increase in East-West trade, and believe that such an increase would contribute to Bloc interests. However, if any such increase took place, it would be carefully limited by Communist leaders to trade in those commodities and through those channels which would serve their foreign political and economic objectives, and would hasten the expansion of their respective economies."

(2) Paragraph 32, p. 30. "This estimate rests largely on our belief that China will continue to place overriding emphasis on imports of commodities essential to building its modern industrial sector, particularly heavy industry and transportation, and in modernizing its armed forces."

(3) Paragraph 2, p. 5. "Since 1950 China has succeeded in increasing its foreign trade and has concentrated on importing military equipment, capital goods, and industrial raw materials."



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VII. NIE 100-55 does not reflect clearly the pattern of the economy of Communist China, its present stage of development and current rate of growth.

The consequences of this deficiency are:

1. There is no qualitative analysis of the impact of a system of selective security trade controls, nor is there an estimate of the qualitative (composition) aspects of any given volume of imports, even though a varied assortment of individual observations attest fully the special character of Communist China's import trade since 1950.

2. Similarly no adequate recognition is evident of the occurrence of imbalances and of technological bottlenecks in industrial growth. They are particularly characteristic of a comparatively primitive economy such as China's when dependence upon foreign replacements and spare parts is great and where substitutions and other adjustments are difficult.

The consequences of a relaxation of controls over exports to Communist China should be appraised or evaluated in terms of the potential contribution to China's capabilities for making short-run adjustments to the succession of bottlenecks which are unavoidable. The ability and freedom of choice to import critical items would facilitate the industrial expansion far out of proportion to the gains indicated by the value of the imports.

3. The potential effects of a relaxation of Western trade controls on industrial expansion in Communist China is indicated in the following statements:



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(1) the estimated gain in "the value of the additional goods imported would be equal to about 10 percent of the total amount currently allocated to industrial and transportation investment in the Chinese budget. (para 31, p. 30);

(2) it is important to note that this available foreign exchange together with additional sources of supply for goods would permit a considerably more flexible and efficient employment of total investment resources." (para 31, p. 30);

(3) an increase in capital goods imports would have enabled the regime to utilize its <u>total</u> investment resources with greater effectiveness (para 14, p 17). These significant facts are not cited or reflected in the Conclusion.



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